

December 2006

Economic Overview

A Presentation to the Tennessee State Funding Board
by
Jeff Wallace, Ph.D.

**Sparks Bureau of Business and Economic Research/
Center for Manpower Studies
The University of Memphis**

December 15, 2006

I. National Summary – Positive Factors

- 1. Five years of uneven but positive economic growth.**
- 2. Third quarter 2006 GDP increased 2.2 percent, while second quarter was 2.6 percent. In contrast, GDP grew at 5.6 percent in the first quarter of 2006. While GDP growth remains positive, it is slowing.**
- 3. Corporate profits have rebounded since slumping slightly in Q3 of 2005 (hurricane effects) but show signs of slowing.**
- 4. Construction activity in Non-Residential Structures is relatively strong.**
- 5. Unemployment is at a 5 ½ year low: 4.4 percent in October 2006.**

I. National Summary – Positive Factors

- 6. Little inflation: 1.8 percent in Q3 2006, and 2.0 percent excluding fuel and energy (seasonally adjusted at an annual rate).**
- 7. Productivity remains strong enough to help offset relatively high fuel and energy prices.**
- 8. Stock markets gaining traction.**
- 9. Business inventories/sales ratio remains low.**
- 10. Retail sales remain strong despite higher fuel and energy prices.**
- 11. Energy prices have begun to fall.**

I. National Summary – Negative Factors

- 1. Sharp drop in residential construction and sales. Particularly hard on mortgage companies/banks with large holdings in CA, AZ, FL.**
- 2. Consumer confidence falling, negatively impacted Middle East and North Korea turmoil.**
- 3. Terrorist threats...and risks are high.**
- 4. Growth in Real Disposable Personal Income has been stagnant.**
- 5. Outsourcing expected to continue, impacting the lowest-skilled the most.**
- 6. New Fed Chairman Bernanke is similar to Greenspan: very narrow focus on inflation.**

I. National Summary - Negative Factors

- 7. Stock market instability – Mid-East turmoil, consumer confidence, new Fed Chairman.**
- 8. Over production of gas guzzlers, rising health care and pension costs continue to eat at long-term corporate health of the Big Three auto makers. Uncertainty at Saturn plant.**
- 9. GDP growth unsustainable unless jobs are created. 2005 was the first year that Total Nonfarm Employment surpassed 2001 peak levels.**
- 10. Savings rates are at record lows. Higher fuel prices will eventually cut into consumer spending.**

Other Factors

- 1. Sustained higher oil and gas prices driving growth in exploration and alternative fuels (ethanol, biodiesel, etc.). Two new plants in Memphis (Milagro and Memphis Biofuels). Benefit to Ag, rail, and trucking companies.**
- 2. Oil/gas prices eating away at airlines, contractors, and road builders.**
- 3. Outsourcing has meant increased trade with China, India – a boon to U.S. railroads, FedEx, and UPS (and Memphis). China/India buying more U.S. goods and services in return.**

II. Summary for Tennessee and Memphis – Positive Factors

- 1. International Paper, Nissan corporate moves to Tennessee.**
- 2. Hino Motors opening manufacturing facilities across the river from Memphis in Arkansas.**
- 3. Bodine Aluminum Toyota engine facility in Jackson.**
- 4. Memphis Bio-Tech sector: St. Jude expanding, Medtronic Sofmar Danek profitable and expanding. New UT College of Pharmacy GMPF.**
- 5. FedEx, AutoZone both profitable. FedEx growing on international trade.**

II. Summary for Tennessee and Memphis – Positive Factors

- 6. Canadian National intermodal and railyard expansion in Memphis (additional 35 trains per day).**
- 7. Assuming U.S. economic growth continues, Tennessee and Memphis will grow, but only if U.S. growth is strong.**
- 8. No housing bubble in Memphis to bust. Residential sales up 7.8 percent YTD (October) but permit growth is negative and average sales price growth is slowing.**
- 9. October Tennessee unemployment was relatively low, even in the City of Memphis: (TN = 4.5%, Memphis = 5.4%).**

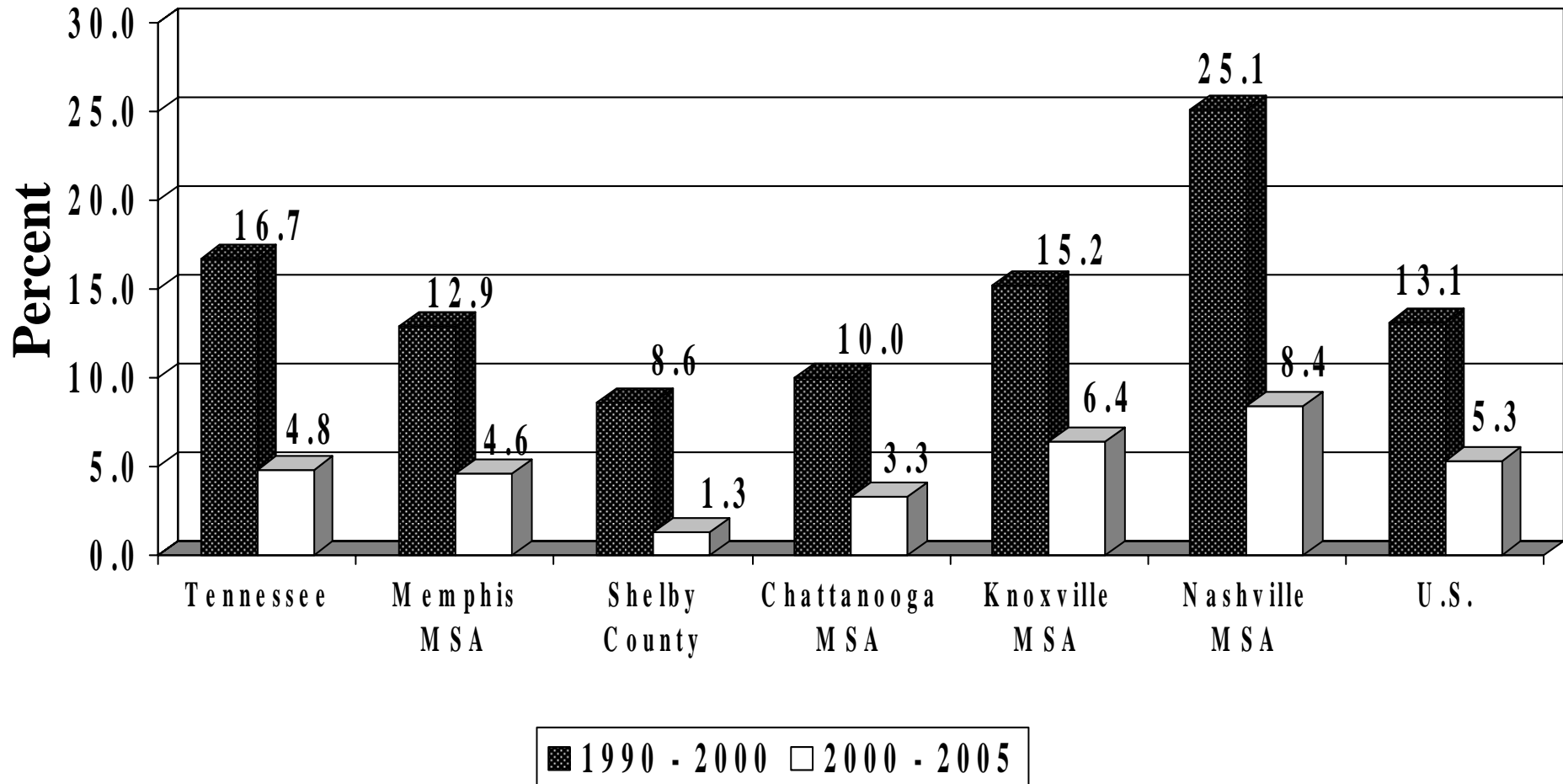
II. Summary for Tennessee and Memphis – Negative Factors

- 1. Outsourcing continues: a largely undereducated workforce unable to compete with lower-cost foreign competitors.**
- 2. Associated loss of manufacturing jobs is particularly severe for rural counties.**
- 3. Weak support for higher education hinders state's ability to compete in global economy.**
- 4. The cost of health care will continue to absorb revenue increases for state government.**

II. Summary for Tennessee and Memphis – Negative Factors

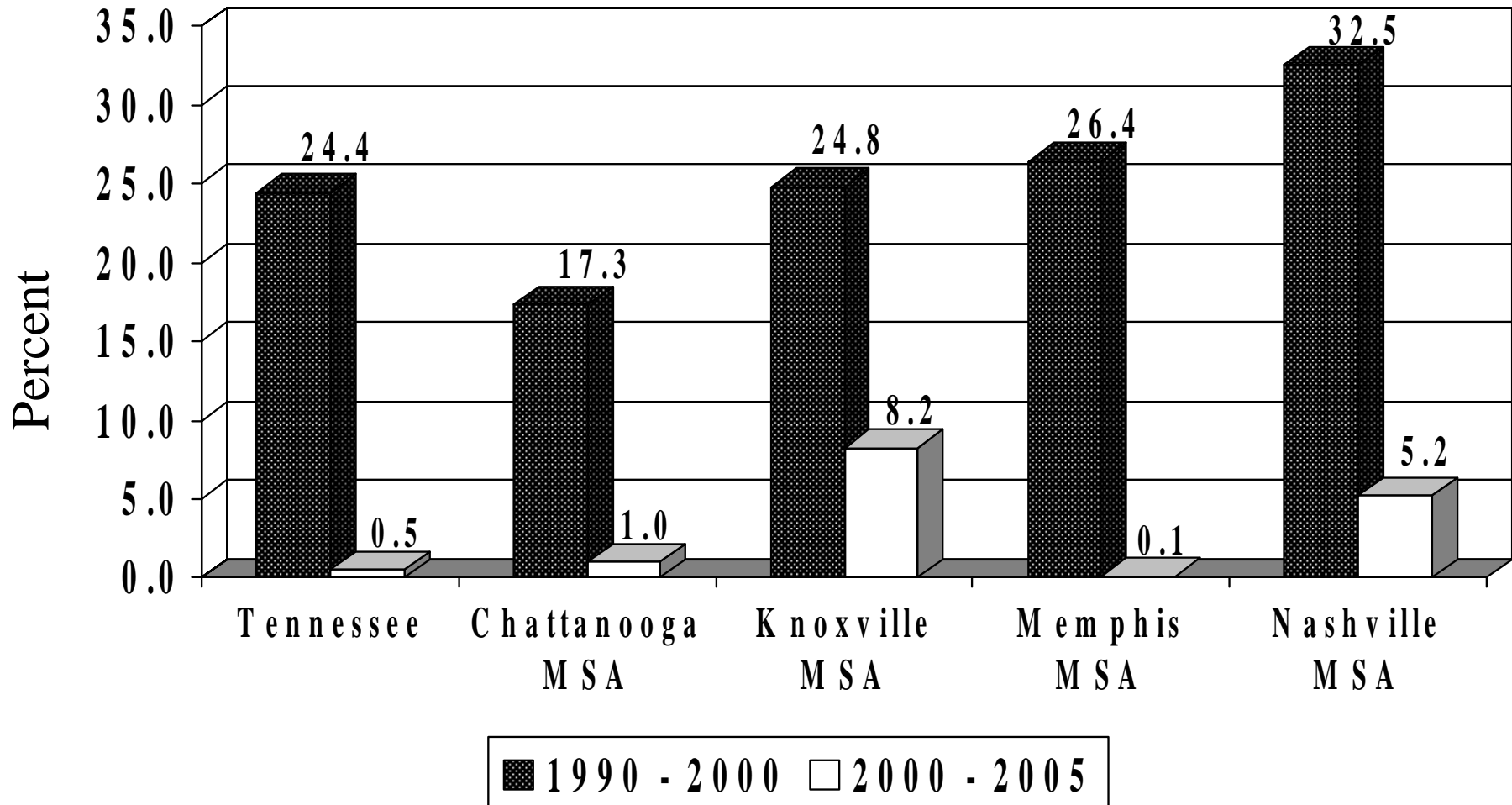
- 5. Rising violent crime in Memphis and rating as one of the most dangerous U.S. cities will hamper the ability to attract new business and residents.**
- 6. A cold winter combined with significantly higher natural gas prices will negatively impact retail sales.**
- 7. Fiscal year-to-date state tax collections are below budgeted estimates (through October) and will increase the pressure to raise taxes and or make budget cuts. County and Municipal governments will bear the brunt of some of the cuts, if any.**

Chart 1. Population Growth, 1990 – 2005 (%)



Source: U.S. Census Bureau.

Chart 2. Employment Growth, 1990 – 2005 (%)



Source: U.S. Bureau of Labor Statistics.

Table 1. Shelby County Residential Construction Permits, September 2005 to September 2006

Type	Building	Units	Construction Cost
Single Family	-19.31%	-19.31%	-12.09%
Two Family	NA	NA	NA
Three and Four Family	300.00%	336.36%	140.39%
Five or More Family	20.00%	124.18%	70.78%
Total	-18.48%	-4.70%	-8.42%

Source: U.S. Census Bureau

Summary

- **Most U.S. economic variables are positive, but GDP growth is slowing.**
- **U.S. housing market may have bottomed out.**
- **TN housing market is o.k., but new construction is slowing.**
- **Fuel prices are moderating.**
- **Growth in TN is mainly in Nashville and Knoxville – not in Memphis and West TN.**
- **Employment within TN is just now at peak levels since 2000.**
- **Overall Outlook: Slow to moderate growth.**